

ANNUAL FINANCIAL REPORT OF CALIFORNIA K-12 SCHOOLS

Report to the Superintendent of Public Instruction

For the Period of July 1, 2004, through June 30, 2005



STEVE WESTLY
California State Controller

October 2006



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California State Controller

October 6, 2006

The Honorable Jack O'Connell
State Superintendent of Public Instruction
California Department of Education
P.O. Box 944272
Sacramento, CA 94244-2720

Dear Mr. Superintendent:

I am pleased to announce the completion of the *Annual Financial Report of California K-12 Schools* for 2005. The report summarizes the financial and program compliance status of the State's school districts and county offices of education for fiscal year (FY) 2004-05, unless otherwise specified. I hope the report will be useful to you and the Legislature in planning California's future education needs.

The financial health of most of California's 978 school districts and 58 county offices of education improved during FY 2004-05. As a whole, California's local educational agencies received more money than they spent, an improvement over last fiscal year. The number of districts and county offices of education filing negative or qualified interim certifications decreased, from 79 in FY 2004-05 to 46 in FY 2005-06. In addition, the number of school districts engaged in multi-year deficit spending decreased, from 339 districts in FY 2003-04 to 228 districts in FY 2004-05.

However, State and federal compliance findings noted in the independent auditors' reports of school districts increased from the prior year. Auditors reported 1,114 compliance findings in FY 2004-05, a 38.7% increase over the 803 reported in FY 2003-04. Moreover, 30.1% of the compliance findings were related to deficiencies in average daily attendance (ADA) accounting, which is the primary basis for the allocation of State funding. The independent audit reports also noted that 96 of the 881 school districts (10.9%) participating in the Class-Size Reduction Program failed to fully comply with program reporting requirements, an increase of 3% over the prior year.

Please direct any comments regarding the content of the report to Michael Carter, Chief Operating Officer, at (916) 445-3028.

Sincerely,

Original signed by

STEVE WESTLY

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Executive Summary

The State Controller has broad authority to oversee state and federal funding of California's public schools from kindergarten through the 12th grade (K-12). The State Controller's goal is to promote greater fiscal accountability by local school districts and county offices of education and to function as the independent protector of taxpayer dollars.

This oversight responsibility includes reviewing annual school district audit reports, maintaining a database with financial and statistical data on school district audit reports, reviewing and certifying the audit reports submitted by independent auditors, tracking financially troubled school districts identified by the interim reporting process, developing and submitting the content of the *Standards and Procedures for Audits of California K-12 Local Educational Agencies* to the Education Audit Appeals Panel, and conducting financial and program audits at various school districts.

This year's report contains the following key findings.

- California's local educational agencies, as a whole, received more money than they spent, an improvement over last fiscal year.
- Three school districts had significantly low fund reserves (1% or less of their general fund expenditures).
- The number of districts engaged in multi-year deficit spending decreased. Compared to 339 districts in the prior year, 228 districts in FY 2004-05 engaged in multi-year deficit spending, a decrease of 32.7%. Although some school districts may legitimately need to engage in multi-year deficit spending (such as for building projects), this practice is often an indication that a district is facing financial difficulties.
- Long-term borrowing increased by \$4.332 billion to a total of \$8.520 billion, a 103% increase over the \$4.188 billion reported in the prior year. Generally, school districts issue long-term debts to fund capitol improvements, refinance existing debts, or buy land for future use.
- The number of districts and county offices of education filing negative or qualified certifications in at least one of the two periods decreased, from 79 in FY 2004-05 to 46 in FY 2005-06. In the second reporting period of 2005-06, 28 school districts and one county office of education filed qualified interim financial reports and four school districts filed negative interim financial reports. Continuing financial difficulties may have a negative impact on these districts' educational programs.

¹ Title 5, *California Code of Regulations*, Sections 15443 and 15456, establishes standards for minimum reserves.

- The number of state and federal compliance findings increased over the prior year. Approximately 30% of the compliance findings for FY 2004-05 are related to deficiencies in average daily attendance (ADA) accounting, which is the primary factor in determining the amount of funding a school district receives from the State.
- The school districts' annual audit reports disclosed 96 audit findings for the 881 elementary school districts participating in the Class-Size Reduction Program. The reports also disclosed 103 audit findings for the 978 K-12 school districts and 58 county offices of education that received Instructional Time and Staff Development Reform Program funds.

Most of the information used to prepare this report is compiled from annual audit reports prepared for individual school districts by independent certified public accountants for FY 2004-05. Additional data was taken from interim financial report certifications submitted by school districts during FY 2005-06. Also, information related to the emergency loan apportionments was obtained from various sources including the California Department of Education.

Introduction

The State Controller's Office's (SCO) oversight role in the K-12 fiscal process is administered by its Division of Audits. Oversight activities focus primarily on three areas: financial indicators, program compliance, and quality control.

The SCO is also responsible for financial oversight of school districts (including county superintendents of schools), in accordance with *Education Code* Section 14500. Its responsibilities include:

- Developing, in consultation with the Department of Finance, State Department of Education, and other school representatives, an annual audit guide² that prescribes financial statements and other information that should be included in each school district's audit report and that provides guidance to independent auditors conducting school district audits;
- Reviewing each school district's audit report submitted to the State and performing the associated follow-up actions, including compliance audits³;
- Tracking notifications from the school districts that identify substantial fiscal problems at interim reporting periods;
- Conducting selected school districts' annual financial and compliance audits as a condition of the districts receiving emergency State apportionment loans;
- Ensuring that satisfactory arrangements for an annual audit have been made for each school district;
- Performing quality control reviews of independent auditors; and
- Compiling pertinent data and reporting annually to the California State Legislature and the California Department of Education.

² *Standards and Procedures for Audits of California K-12 Local Educational Agencies* (K-12 Audit Guide). The *Education Code* states that the Controller, in consultation with the California Department of Education, the California Department of Finance, representatives of the California School Boards Association, the California Association of School Business Officials, the California County Superintendents Educational Service Association, the California Teachers Association, and the California Society of Certified Public Accountants, shall recommend the statements and other information to be included in the audit reports filed with the state and shall propose an audit guide to carry out the purposes of this chapter. A supplement to the audit guide may be suggested in the audit year, to address issues resulting from new legislation in that year that changes the conditions of apportionment. The proposed content of the audit guide and any supplement to the audit guide shall be submitted by the Controller to the Education Audit Appeals Panel for review and possible amendment.

³ Compliance audits are conducted to determine whether categorical state and federal program funds are expended in accordance with the applicable program laws and regulations.

Financial Indicators

Overview

Education Code places school district finances under the control of county offices of education and the California Department of Education. The law protects the public's interest in education by giving county offices of education specific responsibility for fiscal oversight of districts within their jurisdictions.

Key financial indicators representing the financial health of school districts are presented in this section of the report. Most of the indicators are based on data from annual audit reports prepared by independent certified public accountants (CPAs) for FY 2004-05. State law requires school districts to submit, approximately six months after the end of a fiscal year, an independent audit report to the State Controller's Office and the California Department of Education. Additional data comes from interim financial report certifications submitted by school districts during FY 2005-06 and from audits conducted by the State Controller's Office. Each section of the report specifies the fiscal year for which the data was obtained.

Interim Reporting

School districts in California are required to file interim reports certifying their financial health to the governing board of the district and to the county office of education. These interim reports must be completed twice a year by every school district (to cover the periods of July 1 through October 31, and November 1 through January 31) and must be reviewed by the appropriate county superintendent of schools. The interim reports must be in a format or on forms prescribed by the State Superintendent of Public Instruction and shall be based on Standards and Criteria for Fiscal Stability adopted by the State Board of Education pursuant to *Education Code* Section 33127.

One of the following three certifications must be designated by the school district or county office of education when certifying the district's fiscal stability on the interim report.

Positive: A school district or county office of education that **will** meet its financial obligations for the **current fiscal year and subsequent two fiscal years**.

Qualified: A school district or county office of education that **may not** meet its financial obligations for the **current fiscal year or subsequent two fiscal years**.

Negative: A school district or county office of education that **will not be able to** meet its financial obligations for the **current fiscal year or subsequent fiscal year**.

School districts that file qualified or negative interim reports work with their county school superintendent to implement corrective action. Copies of the qualified or negative certifications are forwarded to the State Controller's Office and the Superintendent of Public Instruction.

Decrease in number of districts that filed qualified or negative certifications

During FY 2005-06, 32 of the 978 school districts and 58 county offices of education in the state filed a qualified certification, and 5 districts filed a negative certification for the first period interim report. Of the 37 local education agencies (LEA), 20 filed a second-period qualified interim report, four filed a second-period negative report, and 13 districts were able to take corrective action. However, an additional nine districts filed qualified second-period interim reports, for a total of 33 LEA filing qualified or negative certification for the second-period interim report (Table 1). Thus, 45 districts and 1 county office of education reported qualified or negative classifications in at least one of the two periods (Appendix A), and 19 school districts and one county office of education remained on the list from the prior year. LEA's filing qualified or negative interim reports for two or more years are monitored closely by the State Controller's Office through continuous contact with the California Department of Education.

The most common causes of fiscal problems cited in qualified or negative certifications were (Appendix B):

- Deficit spending
- Salary and benefit negotiations
- Declining enrollment
- Special Education and other restricted fund encroachment
- Inadequate reserves

Table 1

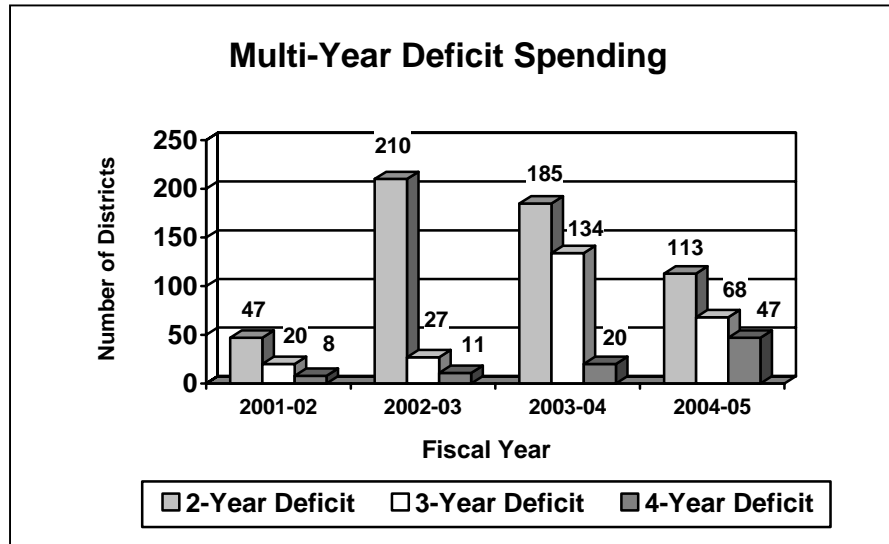
SECOND-PERIOD INTERIM REPORTING HISTORY					
	<u>2001-02</u>	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>2005-06*</u>
Positive	1,003	978	996	979	1,003
Qualified	34	55	35	47	29
Negative	<u>6</u>	<u>8</u>	<u>9</u>	<u>14</u>	<u>4</u>
Totals	<u>1,043</u>	<u>1,041</u>	<u>1,040</u>	<u>1,040</u>	<u>1,036</u>
* Additional information regarding LEAs that filed qualified or negative interim reports during FY 2005-06 is provided in Appendices A and B.					

Deficit Spending

School district multi-year deficit spending decreases

During FY 2004-05, single-year deficit spending decreased to 122 districts from 255 districts in the prior fiscal year.

The overall number of districts relying on multi-year deficit spending decreased (Table 2). However, four-year deficit spending increased by 135%, to 47 districts. Deficit spending patterns are closely monitored by the county offices of education and the California Department of Education to determine whether the districts are facing serious financial problems.

Table 2

Emergency Apportionments

When the governing board of a school district determines that the district's revenues are not sufficient to meet its current-year obligations, it may request, through legislation, an emergency apportionment loan. As a condition of acceptance of the loan, the superintendent appoints an administrator or trustee to control, monitor, and review the operation of the district. The administrator or trustee helps the district develop a five-year recovery plan.

School districts making timely payments

During the past 24 years, the State has granted from the general fund more than \$224 million in emergency loans to school districts. The emergency loans are designed to provide an advance of apportionments owed to the districts from the State School Fund.

Table 3

DISTRICTS WITH OUTSTANDING LOANS (in millions)						
Fiscal Year	School District	Initial Loan			Lease Revenue Bonds*	
		Amount of Loan	Out-standing Balance	Final Repay-ment Date	Amount Issued	Final Repay-ment Date
1990-91	West Contra Costa Unified	\$28.5	—	12/08/2005	\$15.7	08/15/2018
2001-02	Emery Unified	\$2.3	\$1.1	09/30/2021	—	
2002-03	West Fresno Elementary	\$2.0	\$1.1	12/30/2013	—	
2002-03	Oakland Unified	\$100.0	\$37.8	06/05/2023	\$59.8	08/15/2023
2003-04	Vallejo City Unified	\$60.0	\$27.2	06/24/2024	\$21.2	08/15/2024

* The lease revenue bond information was obtained from the California Infrastructure and Economic Development Bank. The outstanding balances on the lease revenue bonds are not shown since audited amounts will not be available until the annual FY 2005-06 financial school district audits have been performed.

During FY 2004-05, five districts had loan balances in amounts ranging from \$1.1 million to \$62.2 million. Recently, Assembly Bill (AB) 1554 was enacted to authorize West Contra Costa Unified School District and Oakland Unified School District to use lease financing to repay the emergency apportionments made from the State's general fund. AB 1554 also specifies that the emergency loan made to the Vallejo City Unified

School District through legislation enacted during FY 2003-04 should be considered an interim loan and requires that the interim loan be repaid with the proceeds of a lease financing.

The lease financing specified in AB 1554 is made available by the California Infrastructure and Economic Development Bank (I-Bank) and shall not exceed 20 years. I-Bank issues the bonds to finance the emergency apportionments and related costs. In December 2005, I-Bank issued bonds to reduce or eliminate the initial loans, as identified in Table 3.

The lease financing payments for Vallejo Unified School District and West Contra Costa Unified School District are due semi-annually, in February and August. Annual payments for Oakland Unified School District are due in August.

Annual payments on the initial emergency loans for the Oakland Unified School District, Emery Unified School District, and West Fresno Elementary School District are due in June, September, and December, respectively. Vallejo City Unified School District annual payments are due in June.

General Fund Revenues and Expenditures

For FY 2004-05, general fund revenues exceeded expenditures, an improvement over the prior year, in which general fund expenditures exceeded revenues.

The cumulative fund balance or surplus for California school districts totaled \$5.092 billion at the end of FY 2004-05, an increase of \$620 million from the prior year's total of \$4.472 billion. As part of the total fund balance, the districts are to maintain reserves as a defense against economic uncertainties. The California Department of Education issues guidelines regarding the amount of reserve each district should maintain, based on its total average daily attendance.

Table 4

SCHOOL DISTRICT GENERAL FUND REVENUES AND EXPENDITURES (in billions)									
	Fiscal Years								
	<u>1996-97</u>	<u>1997-98</u>	<u>1998-99</u>	<u>1999-2000</u>	<u>2000-01</u>	<u>2001-02</u>	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>
Revenues	\$29.778	\$32.893	\$35.715	\$38.793	\$44.262	\$45.323	\$44.939	\$46.159	\$49.643
Expenditures	<u>(29.040)</u>	<u>(32.017)</u>	<u>(34.675)</u>	<u>(37.690)</u>	<u>(42.804)</u>	<u>(44.342)</u>	<u>(44.774)</u>	<u>(46.372)</u>	<u>(48.702)</u>
Surplus/(Deficit)	\$.738	\$.876	\$ 1.040	\$ 1.103	\$ 1.458	\$.981	\$.165	\$ (.213)	\$.941

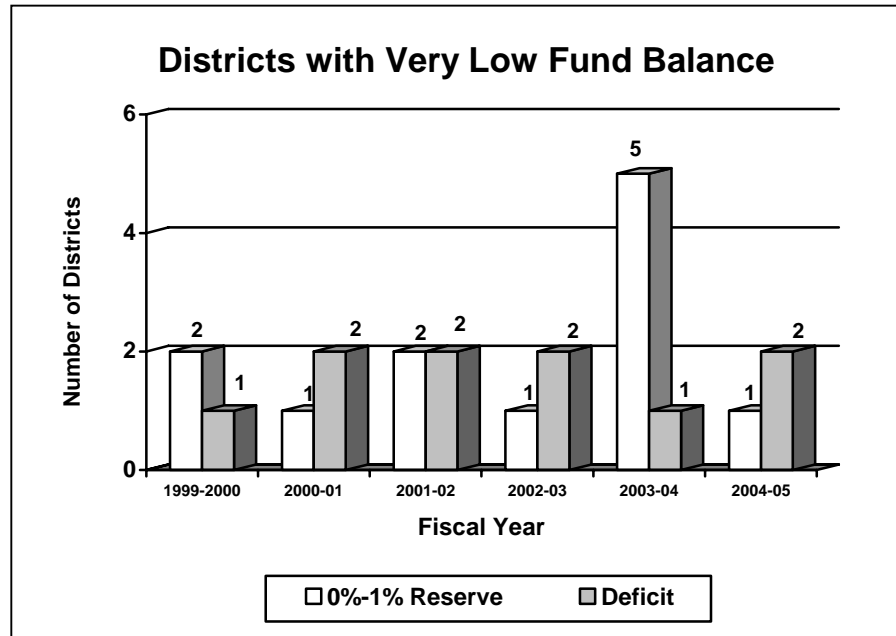
General Fund Balances

In their interim reports, school districts report to county offices of education on projected general fund balances and reserve levels for the current period and two subsequent years. The primary purpose of this reporting is to identify potential deficit spending early in the process, so that the trend can be reversed.

Number of LEAs with significantly low reserves decreased by three

The number of LEAs with significantly low fund balance reserves or deficit balances decreased by three. At the end of FY 2004-05, 3 of 978 school districts and 58 county offices of education had low fund balance reserves (1% or less of general fund expenditures) or negative fund balances (Table 5).

Table 5



Long-Term Borrowing

School districts' long-term borrowing increased

Generally, long-term debt is issued by districts to: fund the purchase, construction, or lease of buildings and equipment; refinance existing debt; or buy land for future use. In the past, it was not uncommon for financially troubled districts to issue long-term debt in order to finance current operations.

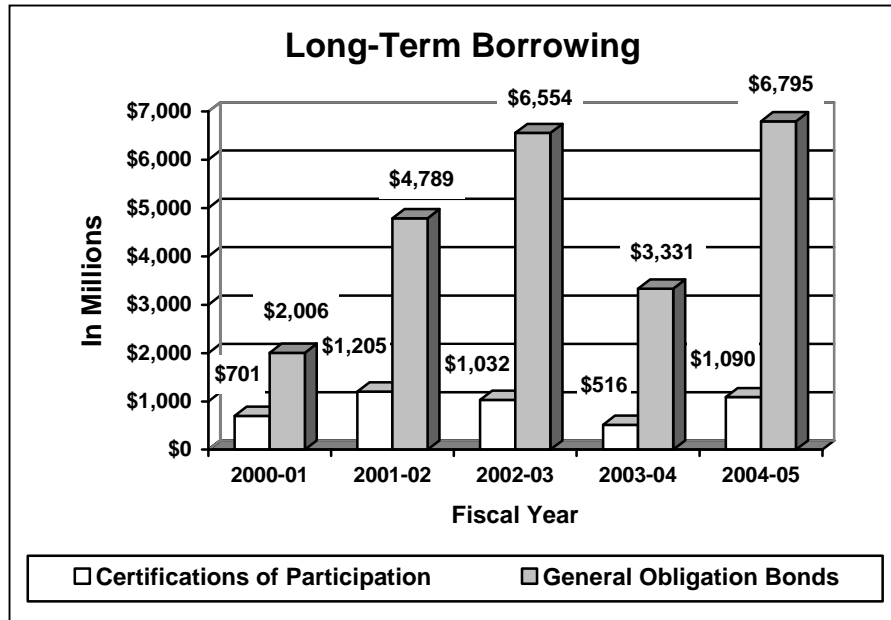
During FY 2004-05, school districts issued \$8.520 billion in long-term debt, an increase of \$4.332 billion over the prior year (103.41%). Based on the information available, this increase is due to districts issuing more long-term debt than in the prior year. Long-term debt financing included:

- **Certificates of Participation (\$1.09 billion, or 13%)**—A financing technique that provides long-term financing through leasing of school facilities, such as buildings, with either an option to purchase or a conditional sales agreement.
- **General Obligation Bonds (\$6.795 billion, or 80%)**—Bonds secured by the full faith and credit of the district. These long-term obligations are generally issued at more favorable rates than are other types of debt because of their preferred status; that is, they are secured by the taxing authority of the district.

- **Limited Tax Obligation Bond Instruments and Other Debt (\$635 million, or 7%)**—A financing technique that provides long-term financing of capital projects. The bonds are repaid from incremental taxes on property in a redevelopment area.

School districts issued \$7.885 billion in certificates of participation and general obligation bonds during FY 2004-05, an increase of \$4.038 billion (104.96%) over the \$3.847 billion in the prior year (Table 6).

Table 6



Financing through certificates of participation increased by \$574 million and financing through general obligation bonds increased by \$3.464 billion over the prior year. The certificates of participation were issued by 55 school districts during FY 2004-05.

Certificates of participation accounted for 13% of long-term borrowing in FY 2004-05, a 1% increase from the previous year. In comparison, general obligation bonds accounted for 80% of long-term borrowing in FY 2004-05, the same amount as in FY 2003-04.

Lottery Revenues

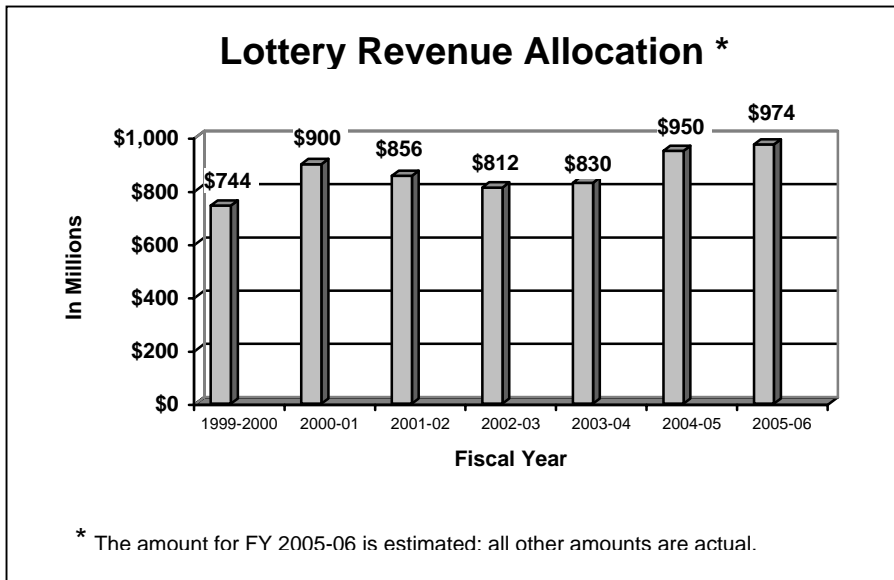
Lottery revenues projected to increase

The allocation of lottery revenues to K-12 school districts is based on a percentage of total lottery sales for the year. Under state law, a minimum of 34% of lottery sales must be distributed to school districts, community colleges, and other educational agencies. The division of this 34% between K-12 school districts and junior colleges fluctuates annually.

The amount is distributed to each district based on its K-12 average daily attendance. The data regarding sales and allocations are maintained by the State Controller's Office and the California State Lottery.

During FY 2004-05, lottery revenue allocated to school districts increased due to higher sales. Revenue for FY 2005-06 is projected to increase by 2.75% over FY 2004-05, up to \$974 million⁴—approximately \$146 per K-12 average daily attendance (Table 7).

Table 7



⁴ The lottery revenue information is obtained from the California Department of Education, based on State Lottery projections.

Program Compliance

Overview

The State Controller's Office reports on program compliance issues as part of its review of annual audit reports, the overall certification process, and associated follow-up actions. In addition, the State Controller's Office conducts compliance audits.

Compliance Findings

Independent auditors determine whether the districts and joint powers entities (JPEs) have complied with state and federal laws and regulations that may have a material effect on the financial position and operations of the organization or program(s) under audit. The JPEs are formed to provide a joint service to a group of districts and are governed by a board consisting of a representative from each member district. When a school district or JPE is not in compliance with applicable laws and regulations, the findings are communicated by the independent auditors in the audit report.

The number of compliance findings contained in the FY 2004-05 school district financial reports submitted by CPAs increased over the prior year. There were 1,114 compliance findings in FY 2004-05, a 38.7% increase over the 803 reported in FY 2003-04 (see Appendix C). The number of attendance accounting findings increased by 74 (from 262 to 336, or 28.2%) over the prior year.

Some of the problems identified in the compliance findings may have a fiscal impact on district operations, as they may result in a loss of state and federal funding. Of the 1,114 audit findings, 903 (81.1%) pertained to state programs and requirements and 211 (18.9%) pertained to federal programs and requirements (see Table 8). Attendance-related findings accounted for 30.1% of compliance findings. The majority of the attendance findings, accounting for approximately 77% of all attendance findings, were related to:

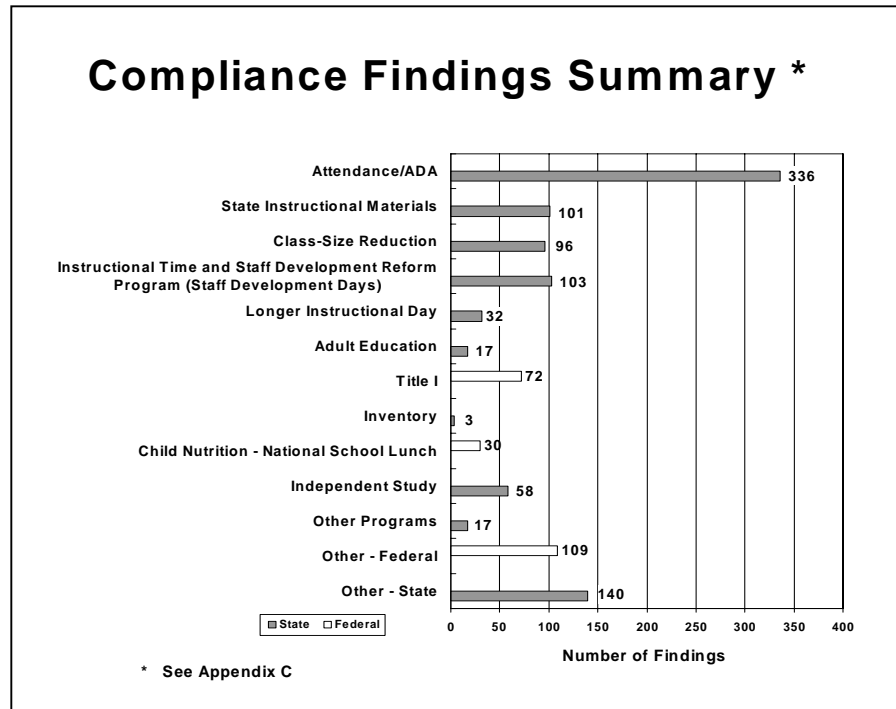
- Overstatement of ADA;
- Kindergarten continuation forms not being maintained and/or not in compliance with state requirements;
- Attendance reports being inaccurate or incomplete;
- Understatement of ADA;
- Absences claimed for apportionment;
- Teachers not possessing a valid certification document; and
- Teachers not being authorized to instruct limited-English-proficient pupils.

The FY 2004-05 school district audit reports also found that 10.9% of the 881 elementary school districts participating in the Class-Size Reduction

Program did not fully comply with program reporting requirements. The audits identified 96 findings relating to the class-size reduction program. Most of the findings pertained to inaccuracies in reporting class-size totals.

The audits also disclosed 103 findings pertaining to the Instructional Time and Staff Development Reform Program. Of these, 61 (59.2%) pertained to overstated applications for funding.

Table 8



Reporting of Findings

Annual audit reports by CPAs are the primary source of information regarding a school district's financial stability and its compliance with state and federal program requirements. Districts' noncompliance with program laws and regulations were not always included in the audit reports. Some compliance problems were either reported to the school district in the independent auditor's management letter or went undetected by the independent auditor.

Audit Resolution Process

Education Code Section 41020(n) requires the State Controller to annually select a sample of county offices of education (COE) on which to perform a follow-up review of the audit resolution process. The scope of the reviews was limited to determining whether each COE followed its formal audit resolution process, resolved all of the audit findings, followed up on the district's corrective action plans, and notified the Superintendent of Public Instruction (SPI) of its results.

In FY 2005-06, the SCO performed reviews of the audit resolution processes of nine COEs.

Our reviews disclosed that one COE did not have a documented audit resolution process, another COE did not maintain documentation to support its follow-up on the apportionment-significant audit exceptions, and a third COE did not follow its audit resolution process. In addition, five of the nine COEs reviewed submitted their certifications of corrective action to the SCO and SPI after the May 15 due date.

Quality Control

Overview

The State Controller, under *Education Code* Section 14504, reviews and certifies the annual independent audit reports submitted by each school district, county office of education, and joint powers entity (JPE) for compliance with audit guidelines set out in the *Standards and Procedures for Audits of California K-12 Local Educational Agencies* (K-12 Audit Guide).

Audit Report Certifications

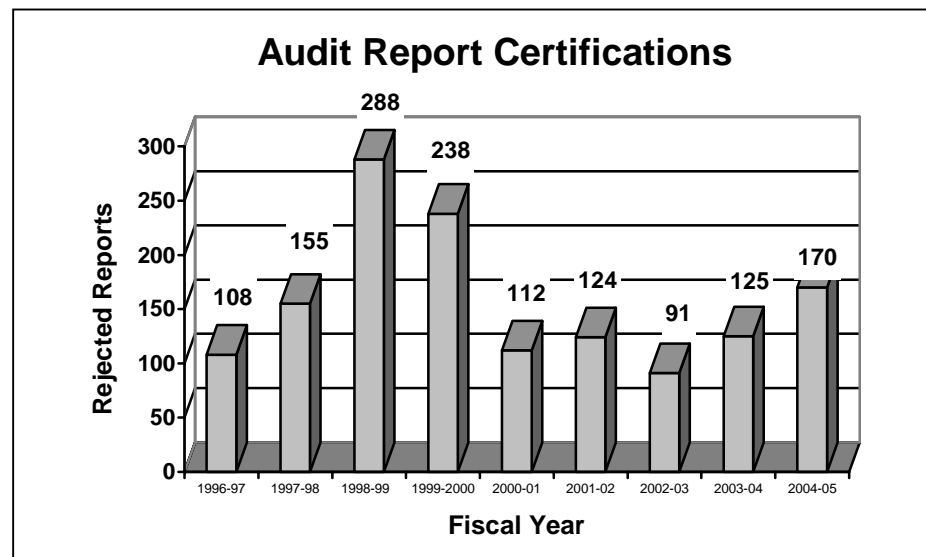
The SCO determines whether audit reports conform to reporting provisions of the K-12 Audit Guide and notifies each school district, county office of education, independent auditor, and the State Superintendent of Public Instruction as to whether its report has been accepted or rejected, based on its conformity with those provisions.

For FY 2004-05, the SCO accepted 84% of the audit reports; the remaining 16% were rejected upon initial review. The SCO subsequently accepted the rejected audit reports after the independent auditors made the requested corrections. Rejection of an auditor's report is accompanied by a penalty whereby the independent auditor does not receive its 10% service fee; this fee retained by the district until the audit report has been corrected and certified by the SCO. In addition, if an independent auditor has had a report rejected (and has not subsequently corrected it) for the same district for two consecutive years, the auditor may be referred to the State Board of Accountancy for professional review.

Increase in rejected audit reports

The number of rejected reports increased by 45 over the prior year from 125 to 170, a 36% increase (Table 9). The rejections were a result mainly of errors in reporting state compliance requirements and quantifying the fiscal impact of state compliance findings.

Table 9

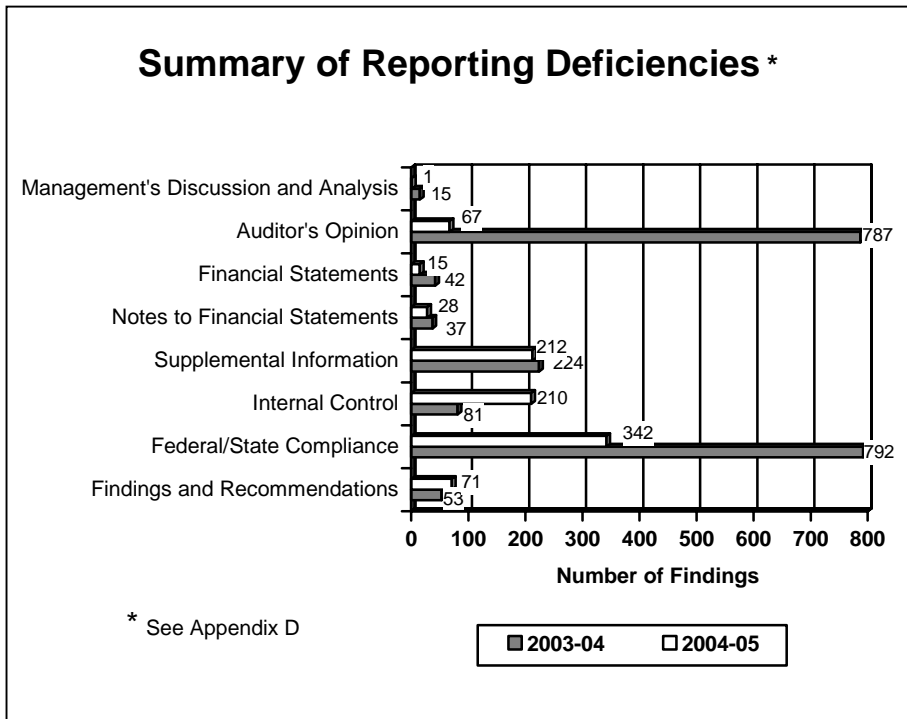


Reporting Deficiencies

Overall reporting deficiencies decreased

Upon initial review, the State Controller's Office certified 863 (84%) of the 1,033 audit reports submitted by independent CPAs for FY 2004-05.

Table 10



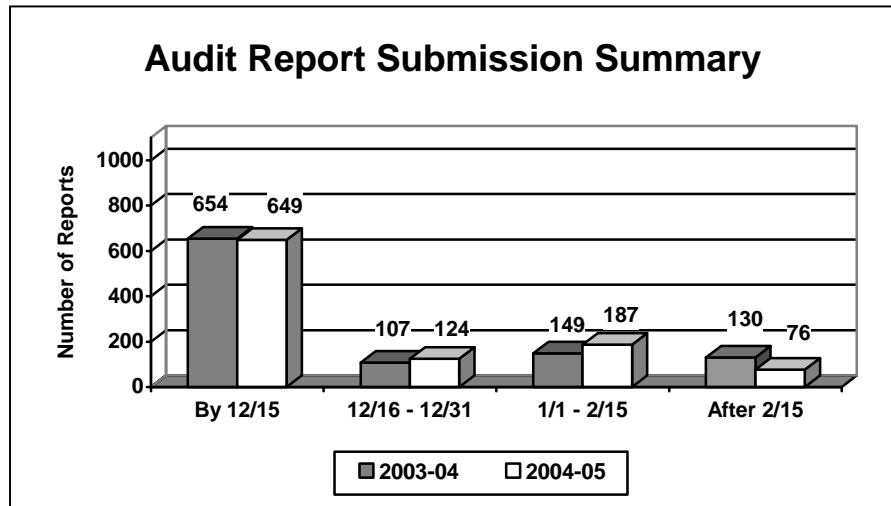
For FY 2004-05, there were 946 reporting deficiencies, a decrease of 1,085 from 2,031 in the prior year (Table 10).

Timely Submissions

Annual reports not submitted on time

Audit reports for the preceding fiscal year must be filed with the SCO, the California Department of Education, and the county superintendent of schools by December 15. Filing deadline extensions may be granted, but only under extraordinary circumstances.

Table 11



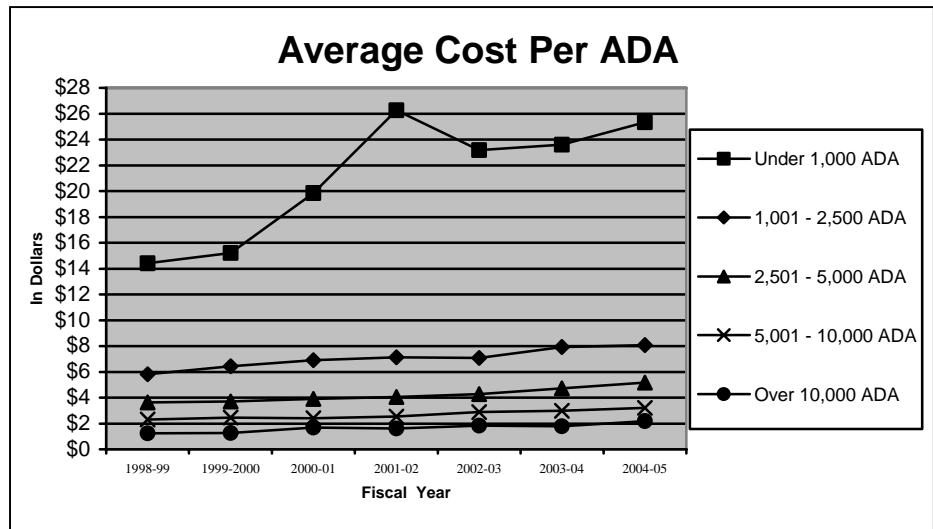
The number of annual audit reports submitted by the deadline decreased from the previous year (Table 11). During FY 2004-5, five fewer reports were received by the December 15 deadline. The majority of annual reports—649 of 1,036, or 63% —were submitted by the deadline. Two reports are still outstanding.

Average Audit Cost per ADA

*Average audit costs
increased slightly*

The State Controller's Office maintains a database of information pertaining to audit contracts between local school districts and independent auditors. From that database, the SCO determined the total audit costs and cost per unit of ADA, for school districts' annual audits. Audit costs for the FY 2004-05 audits totaled \$19.50 million, an increase of \$1.20 million, or 6.5%, over total audit costs of \$18.30 million for FY 2003-04 (Table 12).

Table 12



The average audit cost per ADA increased slightly over the prior year. The largest increase of 21.1% (\$0.38), was for districts with over 10,000 ADA.

Quality Control Reviews

Under Chapter 1128, Statutes of 2002, the State Controller's effort in performing quality control reviews (QCRs) was expanded to include LEAs that have received a negative budget/interim report certification and school districts that have a going concern issue, as determined by the county superintendent. Chapter 1128 also requires the SCO to publish a directory of CPAs whom it deems qualified to conduct audits of LEAs. This directory is published by December 31 of each year.

QCRs are necessary to ensure that the CPAs are adequately reviewing the LEAs, are following generally accepted audit standards and government audit standards, and are including findings regarding financial stability and compliance with state and federal laws in their annual independent auditor's reports.

The general objective of the QCRs is to determine whether the independent auditors are conducting the annual financial audits of LEAs in accordance with:

- Generally Accepted Government Auditing Standards (GAGAS);
- Generally Accepted Auditing Standards (GAAS);
- *Standards and Procedures for Audits of California Local Educational Agencies* (K-12 Audit Guide); and
- Office of Management and Budget (OMB) Circular A-133.

The SCO's opinion regarding the quality of the audits is classified in one of the following categories, based on whether the independent auditor performed the audit in accordance with auditing standards and state and federal requirements.

- If the audit was performed in accordance with the standards and requirements, the SCO's opinion would be that the independent auditor fully complied with auditing standards and state and federal requirements.
- If the audit was performed in accordance with the majority of the standards and requirements, the SCO's opinion would be that the independent auditor complied with the majority of auditing standards and state and federal requirements.
- If the audit was performed in accordance with some elements of the standards and requirements, but the majority of standards and requirements were not met, the SCO's opinion would be that the independent auditor complied with some elements of the standards and requirements, but that the majority of auditing standards and federal and state requirements were not met.
- If the audit was not performed in accordance with the standards and requirements, the SCO's opinion would be that the independent auditor did not comply with auditing standards and state and federal requirements. Such an opinion would result in a referral of the independent auditor to the California State Board of Accountancy.

The SCO issued six final reports during FY 2005-06. Of the six reports:

- Three independent auditors complied with the majority of auditing standards and state and federal requirements; and
- Three independent auditors complied with some elements of the standards and requirements, but the majority of auditing standards and state and federal requirements were not met.

Appendix A— Audit Report and Interim Report Disclosures of Impending Financial Problems

County School District/County Office	Full Disclosure in Auditor's Opinion	Full Disclosure in Financial Statement and Accompanying Notes	2004-05 Average Daily Attendance	2005-06 Interim Report		2004-05 Interim Report Second
				First	Second	
Alameda County:						
1. Oakland Unified	3	3	3	N	N	N
Amador County:						
2. Amador County Office	No	No	267	Q	Q	Q
3. Amador County Unified	No	Yes ¹	4,366	Q	Q	Q
Butte County:						
4. Biggs Unified	No	Yes	739	N	N	N
5. Paradise Unified	No	No	4,937	Q	P	P
El Dorado County:						
6. Gold Oak Union Elementary	Yes	Yes ¹	633	Q	Q	P
Fresno County:						
7. Parlier Unified	Yes	Yes ¹	3,322	N	N	N
8. West Fresno Elementary	Yes	Yes	795	N	Q	N
Kings County:						
9. Delta View Joint Union Elementary	No	Yes	93	Q	Q	N
Lassen County:						
10. Fort Sage Unified	No	No	197	P	Q	P
11. Johnstownville Elementary	No	Yes	236	Q	Q	P
12. Shaffer Union Elementary	No	Yes	353	Q ²	P	P
13. Westwood Unified	Yes	Yes	379	Q	Q	P
Los Angeles County:						
14. Eastside Union	No	No	2,664	Q	P	P
15. Hacienda-LaPuente Unified	No	No	34,215	P	Q	P
16. Las Virgenes Unified	No	Yes ¹	11,677	Q	Q	P
17. Lowell Joint	Yes	Yes ¹	3,153	Q	Q	P
18. Palmdale Elementary	No	No	21,452	Q	Q	Q
19. South Pasadena Unified	No	Yes ¹	4,125	Q	Q	P
Mendocino County:						
20. Anderson Valley Unified	No	No	536	Q	P	P
21. Willets Unified	No	Yes ¹	1,903	Q	P	Q
Monterey County:						
22. Chualar Union Elementary	No	Yes ¹	310	P	Q	P
23. King City Joint Union High	No	Yes	2,259	P	Q	P
24. Salinas City Elementary	No	No	7,990	Q	Q	N
25. Spreckles Union Elementary	No	Yes ¹	908	Q	Q	P
Nevada County:						
26. Pleasant Valley Elementary	No	No	689	P	Q	P
Placer County:						
27. Placer Hills Union Elementary	No	No	1,269	Q	Q	Q
Sacramento County:						
28. San Juan Unified	No	No	50,156	Q	Q	Q
San Benito County:						
29. Aromas San Juan Unified	No	No	1,237	Q	Q	P
30. Hollister Elementary	No	No	5,903	Q	P	Q

Appendix A (continued)

County School District/County Office	Full Disclosure in Auditor's Opinion	Full Disclosure in Financial Statement and Accompanying Notes	2004-05 Average Daily Attendance	2005-06 Interim Report		2004-05 Interim Report Second
				First	Second	
San Joaquin County:						
31. Stockton Unified	No	No	37,288	P	Q ²	P
San Mateo County:						
32. Jefferson Elementary	No	Yes	6,035	P	Q	Q
33. San Mateo Union High	No	Yes ¹	9,887	Q	P	P
Shasta County:						
34. Junction Elementary	No	No	411	Q	Q	Q
Siskiyou County:						
35. Dunsmuir Joint Union High	No	Yes ¹	111	Q	P	Q
36. Willow Creek Elementary	No	Yes ¹	47	Q	Q	P
Solano County:						
37. Benicia Unified	No	No	5,029	Q	P	Q
38. Vallejo City Unified	Yes	Yes ¹	18,085	N	N	N
Sonoma County:						
39. Healdsburg Unified	No	Yes ¹	2,484	Q	Q	Q
40. Monte Rio Elementary	No	No	101	Q	P	P
41. Montgomery Elementary	No	Yes ¹	57	Q	P	P
42. Sonoma Valley Unified	Yes	Yes ¹	4,560	Q	Q	P
Tehama County:						
43. Corning Union Elementary	No	No	1,888	Q ²	P	Q
Tulare County:						
44. Alta Vista	No	No	506	P	Q ²	P
Ventura County						
45. Filmore Unified	No	No	3,663	Q	P	P
46. Rio Elementary	No	Yes	3,873	P	Q	P

Legend: P = Positive Q = Qualified N = Negative

¹ Disclosed in the Schedule of Findings and Questioned Costs.

² County office of education changed certification.

³ Annual audit report has not been submitted; therefore, the information was not available.

Appendix B— Local Education Agencies Filing Qualified or Negative Interim Reports

	Analysis of Key Indicators for Financial Difficulties										
<u>County</u>	1 st /2 nd	Deficit	Below or	Declining	Special	Salary &	Prior Audit	Benefit	“Other”	Litigation	
<u>School District/County Office</u>	<u>Certification</u>	<u>Spending</u>	<u>Inadequate</u>	<u>Enrollment</u>	<u>Education</u>	<u>Benefit</u>	<u>Adjustments</u>	<u>Related</u>	<u>Restricted</u>	<u>and/or Unfair</u>	
			<u>Reserves</u>		<u>Encroach-</u>	<u>Negotiations</u>		<u>Costs</u>	<u>Fund</u>	<u>Labor</u>	<u>Other</u>
					<u>ment</u>				<u>Encroachment</u>	<u>Claims</u>	
Alameda County:											
Oakland Unified ¹	N/N										
Amador County:											
Amador County Office of Education	Q/Q				✓	✓					
Amador County Unified	Q/Q	✓			✓	✓					✓
Butte County:											
Biggs Unified	N/N		✓	✓				✓		✓	
Paradise Unified	Q/P	✓		✓							
El Dorado County:											
Golden Oak Union Elementary	Q/Q		✓	✓	✓	✓			✓		
Fresno County:											
Parlier Unified	N/N	✓			✓				✓		
West Fresno Elementary	N/Q		✓			✓	✓				
Kings County:											
Delta View Joint Union Elementary	Q/Q	✓	✓							✓	
Lassen County:											
Fort Sage Unified	P/Q			✓							✓
Johnstonville Elementary	Q/Q	✓		✓	✓						✓
Shaffer Union Elementary	Q/P		✓	✓							✓
Westwood Unified	Q/Q	✓	✓								✓
Los Angeles County:											
Eastside Union	Q/P	✓	✓	✓		✓	✓				
Hacienda-LaPuente Unified	P/Q	✓		✓		✓					
Las Virgenes Unified	Q/Q	✓	✓	✓		✓					
Lowell Joint	Q/Q	✓	✓	✓							
Palmdale Elementary	Q/Q	✓	✓			✓					
South Pasadena Unified	Q/Q	✓				✓					
Mendocino County:											
Anderson Valley Unified	Q/P	✓						✓			
Willets Unified	Q/P	✓	✓	✓		✓		✓			
Monterey County:											
Chualar Elementary	P/Q			✓							
King City Joint Union High	P/Q					✓				✓	
Salinas City Elementary	Q/Q		✓	✓							
Spreckles Union Elementary	Q/Q				✓	✓					

Appendix B (continued)

County	School District/County Office	Analysis of Key Indicators for Financial Difficulties									
		1 st /2 nd Certification	Deficit Spending	Below or Inadequate Reserves	Declining Enrollment	Special Education Encroach- ment	Salary & Benefit Negotiations	Prior Audit Adjustments	Benefit Related Costs	“Other” Restricted Fund Encroachment	Litigation and/or Unfair Labor Claims
Nevada County:											
	Pleasant Valley Elementary	P/Q	✓		✓			✓			
Placer County:											
	Placer Hills Union Elementary	Q/Q		✓	✓	✓		✓			✓
Sacramento County:											
	San Juan Unified	Q/Q	✓		✓						
San Benito County:											
	Aromas San Juan Unified	Q/Q	✓		✓			✓			
	Hollister Elementary	Q/P	✓					✓			
San Joaquin County:											
	Stockton Unified	P/Q	✓		✓			✓			
San Mateo County:											
	Jefferson Elementary	P/Q	✓	✓		✓		✓			✓
	San Mateo Union High	Q/P				✓					✓
Shasta County:											
	Junction Elementary	Q/Q	✓		✓			✓			
Siskiyou County:											
	Dunsmuir Joint Union High	Q/P	✓		✓	✓		✓			
	Willow Creek Elementary	Q/Q	✓		✓			✓			
Solano County:											
	Benicia Unified	Q/P	✓		✓			✓			
	Vallejo City Unified	N/N	✓	✓	✓	✓				✓	
Sonoma County:											
	Healdsburg Unified	Q/Q			✓	✓		✓			
	Monte Rio Elementary	Q/P	✓	✓	✓			✓			
	Montgomery Elementary	Q/P		✓	✓						✓
	Sonoma Valley Unified	Q/Q	✓					✓			
Tehama County:											
	Corning Union Elementary	Q/P			✓			✓			
Tulare County:											
	Alta Vista	P/Q	✓	✓	✓						✓
Ventura County:											
	Filmore Unified	Q/P			✓	✓					
	Rio Elementary	P/Q		✓				✓			✓

Legend: P=Positive Q=Qualified N=Negative

¹ Interim report did not provide sufficient information to accurately identify key indicators for financial difficulties.

Appendix C— Summary of Audit Report Compliance Findings

<u>Program</u>	<u>Description of Problem</u>	<u>Number of Findings</u>
STATE		
Adult Education	Attendance accounting deficiencies	10
	Attendance report does not reconcile	4
	Other findings	3
Longer Instructional Day	Instructional time requirements not met	17
	Lack of documentation/records	4
	Other findings	11
Continuation Education	Attendance accounting deficiency	21
	Other findings	5
Independent Study	Contract did not include all required elements	20
	Work samples not retained	2
	Attendance overstated	23
	Other findings	13
Summer School	Attendance accounting deficiencies	5
State Instructional Materials Fund	Expenditures not allowable	22
	Adopted/nonadopted requirements not met	26
	Interest earned on allowance not allocated to the program	1
	Board resolution did not address sufficiency of textbooks/instructional materials	13
	Public hearing on instructional materials not held or held after June 30	12
	Notice of public hearing deficiency	19
Attendance Requirements	Other findings	8
	Excused absences—problems with verification procedures/documentation	11
	Attendance accounting system not approved by CDE	1
	Attendance registers/scantrons not signed by teacher	13
	Attendance report does not reconcile to supporting documentation	25
	Attendance report inaccurate/incomplete	27
	Lack of documentation/records	9
	ADA overstated by 0-5 ADA	24
	ADA overstated by 5-10 ADA	3
	ADA overstated by 10-20 ADA	1
	ADA overstated by more than 20 ADA	8
	Kindergarten continuation forms not maintained and/or not in compliance with state requirements	53
	Absences claimed for apportionment	36
	Teacher(s) did not possess a valid certification document	27
	Minimum day requirements not met	1
	Teacher(s) not authorized to instruct limited-English-proficient pupils	53
	ADA understated by 0-5 ADA	13
	ADA understated by 5-10 ADA	5
	ADA understated by 11-20 ADA	6
	ADA understated by over 20 ADA	3
	Enrollment not reconciled to monthly attendance reports	2
	Other findings	15

Appendix C (continued)

<u>Program</u>	<u>Description of Problem</u>	<u>Number of Findings</u>
STATE (continued)		
Inventory of Equipment	Inventory of equipment not maintained	3
Gann Limit Calculation	Appropriation limit calculation deficiency	3
Class-Size Reduction	Number of classes and pupils reported on Form J-7 CSR understated	36
	Number of classes and pupils reported on Form J-7 CSR overstated	49
	Positive daily enrollment records/counts not maintained	1
	Lack of documentation/records	1
	Other findings	9
Deferred Maintenance	Expenditures not allowable	5
	Matching funds not transferred as of June 30	1
	Other findings	1
Instructional Time and Staff Development Reform Program	Applications for funding overstated	61
	Lack of documentation/records	10
	Applications for funding understated	25
	Staff Development held on a minimum day	1
	Other findings	6
Regional Occupational Center/Program	Attendance accounting deficiency	4
Administrator-to-Teacher Ratio	District has not performed and/or incorrect ratio calculation	2
Community Day Schools	Attendance report inaccurate	6
Child Development	Expenditures overstated	1
	Lack of documentation/records	1
California School-Age Families Education (Cal-Safe)	Financial report inaccurate/not complete	3
	Cal-Safe ADA overstated	3
	Other findings	6
Proposition 20 Lottery Funds	Expenditures not allowable	30
School Accountability Report Card	School Accountability Report Cards not published	41
Early Retirement	Certification form not filed/incomplete/inaccurate	2
Other State Programs	Financial report inaccurate/not complete	1
	Lack of documentation/records	1
	Financial report/claim not filed/not filed timely	1
	Expenditures overstated	2
	Other findings	<u>12</u>
TOTAL STATE FINDINGS		<u>903</u>

Appendix C (continued)

<u>Program</u>	<u>Description of Problem</u>	<u>Number of Findings</u>
FEDERAL		
Special Education	Allowable costs/cost principles	21
	Special tests and provisions	2
	Matching, level of effort, earmarking	1
	Other findings	1
Federal Programs	Noncompliance with requirements for allowable costs/cost principles	13
	Noncompliance with requirements for equipment and real property management	1
	Noncompliance with requirements for cash management	2
	Multifunded position not supported by time distribution records	6
	Noncompliance with requirements for procurement/suspension/debarment	1
	Noncompliance with requirements for matching, level of effort, earmarking	1
	Noncompliance with requirements for period of availability of federal funds	1
School Breakfast Program	Activities allowed or unallowed	2
	Eligibility	1
	Other findings	1
National School Lunch	Eligibility of participants	12
	Reporting requirements	1
	Special tests and provisions	2
	Activities allowed or unallowed	7
	Equipment & real property management	1
	Other findings	7
Title I— Grants to LEAs	Special tests and Provisions	4
	Equipment and real property management	4
	Period of availability of federal funds	2
	Expenditures overstated	2
	Allowable costs/cost principles	36
	Lack of documentation/records	2
	Activities allowed or unallowed	3
	Eligibility	7
	Matching, level of effort, earmarking	1
	Other findings	11
Child Care & Develop- ment Block Grant	Allowable costs/cost principles	1
Vocational Education	Allowable costs/cost principles	1
Drug-Free Schools	Period of availability of federal funds	2
Head Start	Eligibility	4
	Allowable costs/cost principles	4
FEMA	Report expenditures do not reconcile to general ledger	1
	Allowable costs/cost principles	2
	Procurement & suspension & debarment	1

Appendix C (continued)

<u>Program</u>	<u>Description of Problem</u>	<u>Number of Findings</u>
FEDERAL (continued)		
Other Federal	Reporting requirements	5
	Allowable costs/cost principles	16
	Equipment and real property management	3
	Lack of documentation/records	3
	Procurement and suspension debarment	2
	Special tests and provisions	1
	Subrecipient monitoring	1
	Other findings	<u>8</u>
TOTAL FEDERAL FINDINGS		<u>211</u>
TOTAL STATE AND FEDERAL FINDINGS		<u>1,114</u>

Appendix D— Summary of Audit Report Deficiencies

Description	Number of Findings	
	2003-04	2004-05
<u>Management's Discussion and Analysis</u>		
The Management's Discussion and Analysis was not included in the audit report.	15	1
<u>Auditor's Opinion</u>		
The auditor's qualified opinion, due to departure from generally accepted accounting principles (GAAP), did not provide substantive reasons for departure and/or did not disclose possible effects on the financial statements.	0	2
The auditor's opinion did not state that the financial statements conformed with accounting principles generally accepted in the USA.	1	1
The auditor's report did not state that the audit was conducted in accordance with auditing standards generally accepted in the USA and government auditing standards (GAGAS).	2	0
Reference to a separate report on internal control over financial reporting and compliance and other matters was not included.	209	4
The auditor's report did not include a manual or printed signature of the auditor's firm and the date of the report.	2	2
The auditor's qualified opinion, due to a scope limitation, did not include paragraph explaining the limitation and/or did not disclose the possible effects on the financial statements.	2	0
The auditor's report did not reference the required supplementary information (RSI).	3	1
The auditor's report did not state that the auditor applied limited procedures to the RSI.	4	1
The auditor's report did not identify supplementary information, including the Schedule of Expenditures of Federal Awards.	5	0
The independent auditor's report did not include an opinion on supplementary information.	12	0
Reference to a separate report on internal control over financial reporting and on compliance and other matters was deficient.	547	52
The auditor's report did not adequately disclose the substantive reasons for the adverse opinion.	0	3
The auditor's report did not identify all component units and/or joint ventures (JPAs) related to the entity.	0	1
Subtotal	787	67
<u>Basic Financial Statements</u>		
Reserves were not appropriate, and their nature and purpose were not clear.	10	1
The Statement of Changes in Fiduciary Net Assets—Fiduciary Funds was not properly presented.	5	0
The Statement of Activities was not properly presented.	2	0
The Statement of Fiduciary Net Assets—Fiduciary Funds was not properly presented.	4	0
The Statement of Net Assets was not properly presented.	3	4
The Balance Sheet—Governmental Funds was not properly presented.	5	1

Appendix D (continued)

Description	Number of Findings	
	2003-04	2004-05
<u>Basic Financial Statements (continued)</u>		
The Reconciliation of the Government Fund Balance Sheet to the Statement of Net Assets was not properly presented.	5	3
The Statement of Revenues, Expenses, and Changes in Fund Balances—Governmental Funds was not properly presented.	6	1
The Reconciliation of the Government Funds Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities was not properly presented.	2	5
Subtotal	42	15
<u>Notes to the Financial Statements</u>		
The notes did not adequately disclose all material items necessary for a fair presentation of the financial statements (long-term debt, issuance of certificates of participation, pension obligations, prior-period adjustments, etc.).	1	0
The notes did not include full disclosure with respect to long-term debt.	26	24
The notes did not adequately disclose prior-period restatements or adjustments.	1	1
The notes did not adequately describe the criteria used in determining whether other entities should be considered component units of the reporting entity.	7	3
The notes did not include adequate disclosure of capital assets and depreciation.	2	0
Subtotal	37	28
<u>Supplemental Information Section</u>		
The Schedule of Expenditures of Federal Awards did not include the required federal catalog numbers, total expenditures for each federal program were not listed, or the schedule did not include all the required programs. For FY 2004-05, the SCO reviewed additional attributes and identified:		
<ul style="list-style-type: none"> Individual federal programs by federal agency and, for a cluster of programs, individual programs within the cluster. For federal awards received as a subrecipient, the name of the pass-through entity and the identifying number assigned by the pass-through entity. 	166	177
The notes did not disclose the district's participation in the Early Retirement Incentive program.	3	16
The reconciliation of annual financial and budget report with audited financial statements was not included.	9	3
The Schedule of Instructional Time was not included or the schedule was deficient.	19	12
The separate budgetary comparison schedule for the general fund and each major special revenue fund was not properly presented.	26	0
The Schedule of Average Daily Attendance was not included.	0	1
The Schedule of Financial Trends and Analysis was not included or the schedule was deficient.	1	0
The Schedule of Charter Schools was not included.	0	3
Subtotal	224	212

Appendix D (continued)

Description	Number of Findings	
	2003-04	2004-05
<u>Internal Control Section</u>		
The Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards did not reference the financial statements audited.	11	3
The Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards was deficient.	58	136
The Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards did not include a statement that the audit was conducted in accordance with GAGAS and auditing standards generally accepted in the USA.	9	2
The Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards did not include a statement regarding legal restrictions on report distribution.	1	1
The Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards did not include a statement regarding test results.	1	9
The Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards did not include a statement that the auditor performed tests of compliance.	1	0
The Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards was not included.	0	29
The management letter was not included in the auditor's report.	0	30
Subtotal	81	210
<u>Federal and State Compliance Section</u>		
The Auditor's Report on State Compliance was deficient.	58	51
The Auditor's Report on State Compliance did not include a statement regarding legal restrictions on report distribution.	53	12
The Auditor's Report on State Compliance cited the incorrect reference for the K-12 audit guide.	632	176
The Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133 (Compliance section) was deficient.	11	1
The Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133 (Internal Control over Compliance section) was deficient.	38	100
The Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133 was not included.	0	1

Appendix D (continued)

Description	Number of Findings	
	2003-04	2004-05
<u>Federal and State Compliance Section</u> (continued)		
The Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133 did not include a statement regarding legal restrictions on report distribution.	0	1
Subtotal	792	342
<u>Findings and Recommendations Section</u>		
The Schedule of Findings and Questioned Costs was not included.	3	0
No report on the auditee's corrective action plan to eliminate noncompliance was included in the report.	6	3
The audit findings were not coded with the correct five-digit number.	8	7
Noncompliance was reported, but sufficient data was not presented.	4	5
The Schedule of Instructional Time indicated noncompliance with the requirements, but the finding was not included in the report.	5	8
The fiscal impact resulting from noncompliance was not quantified.	14	31
Available reserves were below the minimum required and management's plans were not addressed, and/or a going concern note was not included.	5	8
Major federal programs were not identified.	1	0
Sufficient information for judging the frequency and consequences of noncompliance was not included.	5	7
Questioned or unsupported costs material to the financial statements were not properly disclosed.	2	1
The Schedule of Prior Audit Findings was not included.	0	1
Subtotal	53	71
Total number of findings	2,031	946

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